

## Message Text

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ACTION EUR-12

INFO OCT-01 ISO-00 SP-02 USIA-06 AID-05 EB-07 NSC-05  
EPG-02 SS-15 STR-04 OMB-01 CEA-01 CIAE-00 COME-00  
FRB-03 INR-07 NSAE-00 XMB-02 OPIC-03 LAB-04  
SIL-01 L-03 /084 W  
-----071910 062018Z /75

R 061532Z JUL 77  
FM AMEMBASSY BONN  
TO SECSTATE WASHDC 9604  
DEPARTMENT TREASURY  
INFO AMEMBASSY BRUSSELS  
AMEMBASSY PARIS

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USEEC, USOECD

E.O. 11652: NA  
TAGS: ECON, EFIN, GW  
SUBJECT: AGREEMENT ON DIVISION OF VALUE-ADDED TAX REVENUES

REF: A. BONN 8965, B. BONN 2151

1. THE DIVISION OF VALUE-ADDED TAX REVENUES BETWEEN  
THE BUND AND THE LAENDER HAS NOW BEEN AGREED FOR 1977  
AND 1978 IN DIRECT NEGOTIATIONS BETWEEN CHANCELLOR  
SCHMIDT AND THE MINISTER-PRESIDENTS OF THE GERMAN STATES.  
THE WAY HAS THUS BEEN CLEARED FOR PASSAGE BY THE  
BUNDERSRAT OF THE GOVERNMENT'S REVISED TAX PACKAGE (1  
PERCENTAGE POINT INCREASE IN THE VALUE-ADDED TAX, OFFSET  
BY DECREASES IN THE PROPERTY TAX, THE BUSINESS TAX AND  
INDIVIDUAL INCOME TAX--SEE REF A.)

2. THE NEW AGREEMENT--WHICH STILL HAS TO BE RATIFIED  
BY BOTH THE BUNDESTAG AND THE BUNDERSRAT--PROVIDES THAT  
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FOR 1977 NO CHANGE WILL BE MADE IN THE 1976 DIVISION  
OF VALUSE-ADDED TAX REVENUES, I.E., THE BUND WILL RECEIVE  
69 PERCENT AND THE LAENDER 31 PERCENT WITH THE BUND  
MEETING THE CONTRIBUTION TO THE EC OUT OFITS SHARE AND  
THE LAENDER PROVIDING FOR LOCAL GOVERNMENT OUT OF THEIR  
SHARE. THE BUND IN ADDITION WILL CONTINUE TO MAKE SUPPLE-  
MENTAL PAYMENTS EQUIVALENT TO 1.5 PERCENT OF VALUE-ADDED

TAX REVENUES TO FINANCIALLY WEAK LAENDER. FOR 1978 IT WAS AGREED TO REDUCE THE FEDERAL SHARE OF VALUE-ADDED TAX REVENUES TO 67.5 PERCENT AND INCREASE THE LAENDER SHARE TO 32.5 PERCENT. A NEW AGREEMENT HAS TO BE REACHED FOR 1979 AND BEYOND.

3. COMMENT-- THE DIVISION OF VALUE-ADDED TAX REVENUES REPRESENTS A SIGNIFICANT CONCESSION TO THE LAENDER AND A PERSONAL DEFEAT FOR THE FEDERAL MINISTER OF FINANCE. APEL ORIGINALLY HAD CLAIMED (SEE RF B) A 13 PERCENTAGE POINT INCREASE (TO 82 PERCENT) FOR THE BUND ON THE BASIS OF ARTICLE 106 OF THE GERMAN BASIC LAW (CONSTITUTION) WHICH PROVIDES THAT VALUE-ADDED TAX REVENUES ARE TO BE DIVIDED IN SUCH A MANNER THAT BUND AND LAENDER COVER AN EQUAL PERCENTAGE OF THEIR EXPENDITURES BY CURRENT REVENUES. WHILE IT NEVER SEEMED VERY LIKELY THAT APEL COULD GET THE FULL AMOUNT OF HIS CLAIM (WHICH FOR 1977 TRANSLATES INTO DM 8 BILLION), MOST BONN OBSERVERS THIS SPRING FELT THAT HE COULD REALIZE ABOUT DM 3 BILLION OR AT THE VERY LEAST A DM 1.5 BILLION REIMBURSEMENT FOR THE CHILDREN ALLOWANCE OF LAENDER EMPLOYEES WHICH IS NOW PAID BY THE FEDERAL GOVERNMENT.

4. THE NEW AGREEMENT DEMONSTRATES THE STRENGTH OF THE LAENDER IN THE GERMAN FISCAL SYSTEM (THROUGH THEIR LIMITED OFFICIAL USE

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ABILITY TO BLOCK FISCAL LEGISLATION IN THE BUNDES RAT) AND ALSO MAY REFLECT CHANCELLOR SCHMIDT'S DESIRE TO DO ALMOST ANYTHING TO AVOID A BUNDES RAT COUNTERPROPOSAL TO THE GOVERNMENT'S TAX PACKAGE SINCE THIS WOULD THROW THE ISSUE INTO THE BUNDESTAG/BUNDES RAT CONFERENCE COMMITTEE AND EVENTUALLY BACK INTO THE BUNDESTAG. IT THUS COULD REOPEN THE DIVISIVE ARGUMENT IN THE SPD.

5. FROM A BUSINESS CYCLE POINT OF VIEW, THE RELATIVELY FAVORABLE OUTCOME FOR THE LAENDER PROBABLY SHOULD BE WELCOMED. IT IS LIKELY TO RESULT IN SOMEWHAT LARGER OVERALL GOVERNMENT DEFICITS SINCE THE LAENDER AND LOCALITIES ARE SOMEWHAT LESS ABLE THAN THE BUND TO COVER THEIR EXPENDITURES BY TAKING UP DEBT. FROM A LONGER RUN STRUCTURAL POINT OF VIEW, THE STRENGTH OF THE LAENDER IN FISCAL BARGAINING MAY RESULT, HOWEVER, IN GOVERNMENT FUNDS INCREASINGLY BEING AVAILABLE IN GERMANY MORE READILY FOR EXPENDITURE IN AREAS OF LAENDER RESPONSIBILITY THAN FOR SUCH FEDERAL RESPONSIBILITIES AS DEFENSE, FOREIGN POLICY AND FOREIGN AID.

6. FOR MINISTER APEL PERSONALLY THE AGREEMENT CONSTITUTES

A MAJOR DEFEAT AND HIS WHOLE HANDLING OF THE ISSUE IS BOUND, AT LEAST TEMPORARILY, TO TARNISH HIS REPUTATION WITHIN THE SPD. APEL SET OUT SOME YEARS AGO TO "CONSOLIDATE" FEDERAL FINANCES (I.E., REDUCE THE DEFICITS) AND HAS STUCK TO THIS LINE REGARDLESS OF REALISTIC POSSIBILITIES OR THE NEEDS OF ANTI-CYCLICAL POLICY. HE HAS BEEN FORCED TO RETREAT GRUDGINGLY, STEP BY STEP, FROM HIS ORIGINAL PROPOSAL TO INCREASE THE VALUE-ADDED TAX BY 2 PERCENTAGE POINTS WITHOUT ANY OFFSETTING TAX REDUCTIONS. HE HAS ENDED UP WITH A PACKAGE WEAKENING THE FEDERATION FISCALLY VIS A VIS THE LAENDER, INCREASING THE FEDERAL DEFICITS, AND MAKING THE GERMAN TAX STRUCTURE SOMEWHAT MORE REGRESSIVE. IN THE PROCESS HE PUSHED HIS PARTY FACTION IN THE BUNDESTAG INTO A MAJOR LIMITED OFFICIAL USE

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CRISIS. HIS SPD COLLEAGUES IN RETROSPECT CAN HARDLY BE EXPECTED TO FEEL THIS IT HAS BEEN WORTH IT. FROM THE POINT OF VIEW OF BUSINESS CYCLE POLICY, TOO, IT IS DEBATABLE WHETHER NO PACKAGE MIGHT NOT HAVE BEEN BETTER THAN THIS ONE AND THIS ONE CERTAINLY IS BETTER THAN THE ONE APEL WOULD HAVE ENACTED IF HE COULD HAVE HAD HIS WAY. STOESEL

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## Message Attributes

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**Disposition Date:** 22 May 2009  
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**Document Unique ID:** 00  
**Drafter:** n/a  
**Enclosure:** n/a  
**Executive Order:** N/A  
**Errors:** N/A  
**Expiration:**  
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**Original Handling Restrictions:** n/a  
**Original Previous Classification:** n/a  
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**Page Count:** 3  
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**Previous Handling Restrictions:** n/a  
**Reference:** 77 BONN 8965, 77 BONN 2151  
**Retention:** 0  
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**Review Event:**  
**Review Exemptions:** n/a  
**Review Media Identifier:**  
**Review Release Date:** n/a  
**Review Release Event:** n/a  
**Review Transfer Date:**  
**Review Withdrawn Fields:** n/a  
**SAS ID:** 1957145  
**Secure:** OPEN  
**Status:** NATIVE  
**Subject:** AGREEMENT ON DIVISION OF VALUE-ADDED TAX REVENUES  
**TAGS:** ECON, EFIN, GE  
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**Type:** TE  
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**Review Markings:**  
Margaret P. Grafeld  
Declassified/Released  
US Department of State  
EO Systematic Review  
22 May 2009  
**Markings:** Margaret P. Grafeld Declassified/Released US Department of State EO Systematic Review 22 May 2009